Investment Watch

2nd Quarter, 2006

"Blame It On Ben!"

Who could have guessed, that conservatively dressed man with his mild demeanor could utter a few words and roil the stock market, not only here at home, but throughout the entire world? Let's, **"Blame it on Ben!"** the pundits proclaimed, Ben Bernanke, that is, the new Federal Reserve Chairman who succeeded Alan Greenspan.

The press on Bernanke heralded a new "more transparent" Fed, but Ben couldn't fathom the power of his words in the hands of the press. The media has squashed all hope of openness and candor. Dr. Bernanke's academic tutelage stressed frankness which made him easy prey, one more casualty of instant celebrity. The cry *should* be, **"Blame it on the Media!"**

Remember that last quarter's newsletter, *"No More Cheap Money"*, discussed that the Fed's mandate is to fight inflation, to keep prices stable and promote sustainable long-term growth. The main weapon the Fed has to fight inflation is the Federal Funds Rate, which at their June 29th meeting, was incremented another ¼ of a point for the 17th straight time up to 5¼%.

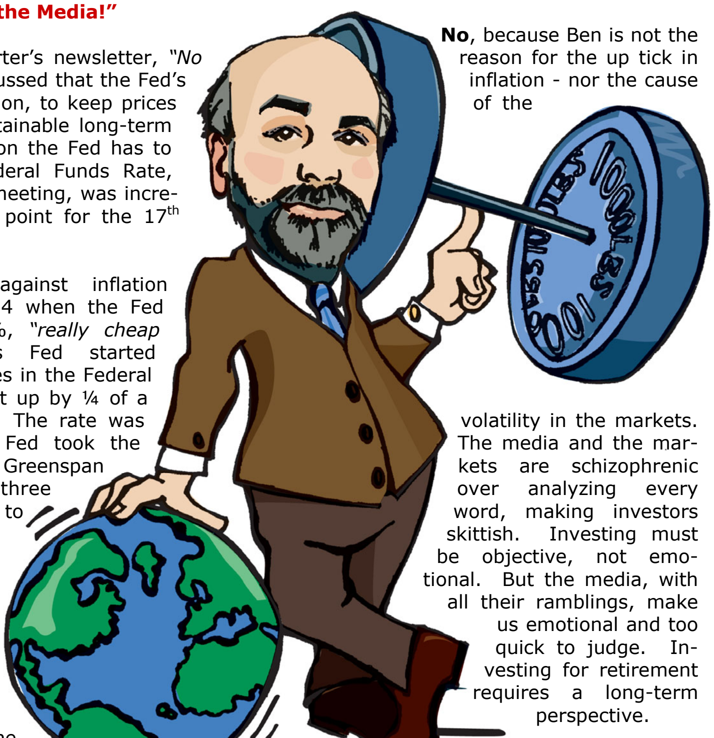
This marathon fight against inflation started back in mid 2004 when the Fed rate was a paltry 1.0%, *"really cheap money"*. Greenspan's Fed started "measured pace" increases in the Federal Funds Rate by stepping it up by ¼ of a point at every meeting. The rate was 4.5% when Bernanke's Fed took the baton and has matched Greenspan stride-for-stride with three additional increases up to the current 5¼%.

But, it wasn't the Fed rate increases which rocked the world markets, it was Bernanke's words while chatting at a private dinner party with CNBC anchor, Maria Bartiromo. Earlier, the press had interpreted Bernanke's congressional testimony at the end of April as dovish and that the Fed **would pause** its interest rate-hiking cycle even if inflation risks remain. The stock markets soared and Bernanke's trouble began.

Making dinner-party small-talk with Bartiromo, Bernanke observed that the markets made a mistake in assuming that his testimony before Congress meant that the Fed was about to stop raising rates and that a pause was not the same as an end of the rate hikes. Many economists believe that the Fed suffered a loss of credibility over this episode. So much so that Bernanke admitted it was a lapse in judgment and promised the Senate Banking Committee that his future "communications with the public and the markets will be through regular and formal channels".

Uncertainty reeks havoc on financial markets and havoc dominated the markets during the last quarter. If you don't follow the market closely, the results reflected in your quarterly statement, although disheartening, mask the volatility that transpired. Most assets continued their first quarter rise into May. But then when the media expressed uncertainty and anxiety about our newly minted Federal Reserve Chairman, Ben Bernanke, the markets tanked.

So let's all, **"Blame it on Ben!"**. Why not believe the media that old Ben just wanted to show a little muscle and prove he was not an inflation dove, but rather, that macho inflation hawk? Why not believe them when they say he flip-flops on key inflation issues? Why not follow the throng of investors who just don't like him? Shouldn't we, **"Blame it on Ben?"**



No, because Ben is not the reason for the up tick in inflation - nor the cause of the volatility in the markets. The media and the markets are schizophrenic over analyzing every word, making investors skittish. Investing must be objective, not emotional. But the media, with all their ramblings, make us emotional and too quick to judge. Investing for retirement requires a long-term perspective.

Rather than just relying on the media's version, let's go straight to the source. After all, the Fed and Bernanke have the most comprehensive view of the long-term prospects of the US economy. The full text of Bernanke's Congressional testimony can be found at www.federalreserve.gov/boarddocs/testimony/2006/20060427. Here are some excerpts — **you be the judge**.

Economic Strength
"...the national economy appears to have grown briskly...and job gains averaged about 200,000 per month. Consumer spending and business investment...are also on track to post sizable first-quarter increases...the pace of economic growth has been strong for the past three years, averaging nearly 4 percent...the prospects for maintaining economic growth at a solid pace in the period ahead appear good. It seems reasonable to expect that economic growth will moderate toward a more sustainable pace as the year progresses."

Productivity and Unemployment
"Much of this growth can be attributed to a substantial expansion in the productive capacity of the U.S. economy, which in turn is largely the result of impressive gains in productivity. Over the past year the unemployment rate has fallen nearly 1/2 percentage point."

Housing
"Both new and existing home sales have dropped back. House prices, which have increased rapidly during the past several years, appear to be in the process of decelerating, which will imply slower additions to household wealth and, thereby, less impetus to consumer spending...this sector will most likely experience a gradual cooling rather than a sharp slowdown. The risk exists that a slowdown more pronounced than we currently expect could prove a drag on growth this year and next."

Energy
"Rising energy prices pose risks to both economic activity and inflation. If energy prices stabilize this year, even at a high level, their adverse effects on both growth and inflation should diminish somewhat over time. However, as the world has little spare oil production capacity, periodic spikes in oil prices remain a possibility."

Inflation
"The outlook for inflation is reasonably favorable but carries some risks. Increases in energy prices have pushed up overall consumer price inflation over the past year or so. However, inflation in core price indexes has remained roughly stable over the past year. Among the factors restraining core inflation are ongoing gains in productivity and strong domestic and international competition...long-term inflation expectations appear to remain well-anchored."

Monetary Policy
"Of course, inflation expectations will remain low only so long as the Federal Reserve demonstrates its commitment to price stability. To support continued healthy growth of the economy, vigilance in regard to inflation is essential. In particular, even if in the Committee's judgment the risks to its objectives are not entirely balanced, at some point in the future the Committee may decide to take no action at one or more meetings in the interest of allowing more time to receive information relevant to the outlook. Of course, a decision to take no action at a particular meeting does not preclude actions at subsequent meetings."

The press and the markets construed this last excerpt to indicate the Fed would stop its rate-hiking cycle which set off the markets manic gyrations. You be the judge, should we —
"Blame it on Ben?"

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